

# Capital Stock and Ownership Program

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## EXAMINATION OBJECTIVES

Identify and determine the nature of ownership and control of the savings association.

Determine whether any individual has exerted a detrimental influence through ownership or control.

Determine if adequate physical safeguards for stock certificates and ownership records are in place.

Determine compliance with applicable laws, rulings, regulations, and any expressed agreements with OTS, FDIC, or state regulators.

Determine the adequacy of the savings association's policies, procedures, and controls related to capital stock.

Review securities filings for information of a supervisory interest and report results of the review to Business Transactions Division (BTD).

Determine if a savings association prudently administers an Employee Stock Ownership Plan (ESOP).

Initiate corrective action when deficiencies exist that could affect safety and soundness, or when you note significant violations of laws or regulations other than securities violations.

## EXAMINATION PROCEDURES

### LEVEL I

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1. Determine through discussions with management and other appropriate verification methods, if management has taken corrective action relative to:

- Prior examination report comments and prior examination exceptions.
  - Internal and external audit exceptions.
  - Any enforcement/supervisory actions and directives.
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<b>Exam Date:</b>	
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<b>Reviewed By:</b>	
<b>Docket #:</b>	

# Capital Stock and Ownership Program

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2. Summarize information from securities offering filings, directors' minutes, audit reports, and other sources pertaining to any new issuance of capital stock (including the payment of stock dividends), notes, subordinated debentures, and other capital instruments. File the information within the continuing examination file (CEF), if applicable.  

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3. Either you or the regional office should make a brief review of the Forms 10-K, 10-Q, 10-KSB, 10-QSB and any other Exchange Act reports. (See [Appendix A](#).) Compare the Exchange Act reports to TFRs, other reports, information, and documents relating to the savings association that are available. Immediately report any material discrepancies between the disclosures contained in the Exchange Act reports and information known to the regional office. The regional office should inform BTB and the Accounting Policy Division (APD) by e-mail.  

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4. Carefully review all transactions involving Treasury stock. Determine whether the board of directors' actions adequately supports Treasury stock transactions. Consider whether transactions have a detrimental effect.  

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5. Update the CEF, if applicable, with the Schedule of Stockholders (PERK 014). Alternatively, summarize the following information for each director and director's interests, officer, attorney, partner, and all other stockholders who own or control five percent or more of the savings association's stock:
  - Number of shares.
  - Percent to total outstanding.
  - Stock certificate number (optional).
  - Issuing price (optional).
  - Date of issue (optional).

<b>Exam Date:</b>	
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<b>Docket #:</b>	

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- Confirm the timely reporting of changes in ownership on Forms 3, 4, 5 or Schedules 13D or 13G by companies subject to the Exchange Act.
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6. Determine stock concentration by noting the total number of shareholders along with the number of shares outstanding.
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7. If the savings association elected S Corporation status since the last examination, perform the following procedures:
- Review the association's eligibility for the election.
  - Review shareholder agreements regarding stock transfers which management will use to maintain compliance with the eligibility requirements.
  - Verify that management has a method for monitoring ongoing compliance with S Corporation eligibility requirements.
  - Confirm that management periodically test and review the method for monitoring compliance.
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8. Review whether the institution has realistic expectations about its ability to increase its capital while maintaining its S Corporation status.
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9. Determine whether the association's management and shareholders understand that limitations may exist on the ability of an S Corporation to pay dividends.
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---

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10. Determine whether management understands the overall effect of any potential dividend distribution limitations on an S Corporation.
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11. Review proxy records from the last election of the directors. Identify anyone who has controlled the election of the board through proxies.
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12. On the basis of information obtained in procedure No. 5 and review of shareholder and related information, consider:
- Whether there was a change in control in the association. If yes, determine if BTD received the information for savings associations subject to the Exchange Act, and if not reported, provide details to BTD for a determination of needed disclosures.
  - Whether ownership, or change in control, of the savings association has significantly affected the savings association's operating policies or mode of operations to the detriment of the savings association.
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13. ERISA and IRS rules and regulations are complex. Accordingly, you should request the ESOP administrator in the savings association to provide evidence that specialist legal counsel assists in helping to maintain the plan in compliance with all applicable rules and regulations. You should request the ESOP administrator to provide evidence that the savings association is able to meet its repurchase liability. The ESOP administrator also should support the stock valuation of closely held savings associations.
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<b>Docket #:</b>	

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14. From a review of plan documents or other appropriate sources, determine the duties and responsibilities of the savings association regarding its ESOP. Ascertain whether the savings association is satisfactorily performing its duties and responsibilities. If the need for expert advice is apparent, you should recommend that the savings association obtain the advice of an ESOP legal specialist. (*Note:* See the Trust & Asset Management Handbook for additional examination procedures if the savings association or its service corporation is acting as trustee, or serving in a fiduciary or similar capacity.)
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15. If the savings association established an ESOP in conjunction with a conversion, determine if the ESOP purchased ten percent or more of the stock offered in the conversion.
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16. Determine if the savings association aggregates stock held in the ESOP with an individual's purchase limitations. (They should not be aggregated.)
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17. Determine if during a conversion the savings association extended its own credit to finance the funding of the ESOP. Also determine if during a conversion the savings association guaranteed the debt incurred by the ESOP when borrowing from another savings association.
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18. Determine if the ESOP is an affiliate or an affiliated person. If so, verify that transactions such as loans and other financing arrangements with the savings association are consistent with OTS and FRB restrictions and prohibitions. (12 CFR §§ 561.5 and 563.43 and Federal Reserve Act §§ 23A and 23B.)
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19. Determine if an ESOP trust acquired control of the savings association or an S&L holding company outside of the conversion process. If so, verify OTS approval of the acquisition of control, as required by § 574.3.
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20. Summarize pertinent information relating to stock option plans and ESOPs and file in the CEF, if applicable.
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21. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.
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## LEVEL II

1. Determine whether the association's management and shareholders understand that prohibitions exist on the ability of an association to make loans or discounts on the security of the shares of its own stock. Verify that the association is in compliance with these restrictions.
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2. Ensure that capital distributions are of the type and in the amount permitted by Part 563, Subpart E – Capital Distributions.
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3. For savings associations subject to the Exchange Act, determine whether the savings association makes timely required filings. If not, contact the regional office or BTB.
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WKP. REF.

4. If the savings association acts as its own transfer agent or registrar, examine the records pertaining to stock certificates to ensure controls are adequate to prevent over issuance of stock.

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5. Ensure that your review meets the Objectives of this Handbook Section. State your findings and conclusions, and recommendations for any necessary corrective measures, on appropriate work papers and report pages.
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## EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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